MINUTES

JOINT MEETING

HOUSE REVENUE & TAXATION COMMITTEE
SENATE LOCAL GOVERNMENT & TAXATION COMMITTEE

DATE: Tuesday, January 16, 2018

TIME: 8:30 A.M.

PLACE: Lincoln Auditorium

MEMBERS: Chairman Collins, Acting Vice Chairman Kauffman, Representatives Moyle, Raybould, Anderst, Dayley, Hartgen, Chaney, Nate, Thompson, Gestrin, Stevenson, Troy, Gibbs, Erpelding, Gannon

Chairman Johnson, Vice Chairman Bayer, Senators Hill, Siddoway, Rice, Vick, Patrick, Burgoyne, Nye

ABSENT/ EXCUSED: None

GUESTS: Nathan Beckman; Doreen Warren, Idaho State Tax Commission (Commission); Miguel Legarreta, ATI; Ben Davenport, Idaho Mining Association; Tom Shaner, Commission; Cynthia Adrian, Commission; Russell Westerberg, RWD.

Chairman Collins called the joint meeting of the House Revenue and Taxation Committee and the Senate Local Government Committee to order at 8:30 p.m. Chairman Collins explained the meeting was an open forum to discuss the complexities and provide information and guidelines on the impacts to Idaho because of federal tax reform.

Ken Roberts, Chairman, Commission, stated the Tax Cut and Jobs Act of 2017 (Act), signed into law by the President of the United States on December 22, 2017, has provisions that will impact Idaho tax payers in both 2017 and 2018. Because Idaho's Income Tax Code uses the Internal Revenue Code (IRC) as a starting point, Idaho's income tax returns begin with a federally adjusted gross income (AGI). The Idaho Income Tax Act, Idaho Code § 63-3002, declares it is the intent of the Legislature, "to make provisions of the Idaho act identical to the Internal Revenue Code relating to the measurement of taxable income . . .." Because Idaho conforms to the federal calculation of taxable income, any changes affecting the calculations will impact the Idaho return and Idaho revenue, and the Legislature decides whether or not to conform to the change. Conformity prevents having two different systems in taxation, and thereby creating more work for CPAs and tax preparers. Conformity does not mean that all changes at the federal level have an impact on what happens at the state level. Changes to federal tax rates or credits, individual and business, including: tax brackets, corporate tax rates, Alternative Minimum Tax, Federal Net Operating Loss (NOL), and bonus depreciation rules have no Idaho impact. Mr. Roberts advised that it is the Legislature's challenge as policy makers to set the policy so that Idaho citizens know what the tax impact is going to be on the dollars they are earning today. Idahoans are already earning in 2018, and they need to know what the tax structure and policy is going to be.

Doreen Warren, Public Information Director, Commission, advised the Act has some retroactive provisions affecting the 2017 tax year and are included Idaho's conformity bill. The federal changes to the personal itemized medical expense deduction takes effect for tax years after December 31, 2016 and sunsets December 31, 2018, and reduces the threshold for all taxpayers from 10% to 7.5% of their AGI for itemizing their medical expenses. The 7.5% threshold is valid for tax years 2017 and 2018 and returns to the 10% threshold for 2019. If Idaho conforms, new forms for tax preparers will not be required, but instructions will need to be updated and communicated. The fiscal impact for FY2018 is approximately $6.4 million and $1.8 million for FY2019. Conformity does not require the Commission to make any internal processing system changes but will require any company using software like Turbotax to make changes to their system. If Idaho doesn't conform to the Act's threshold for itemizing medical expenses, the Commission will need to provide outreach and specific instruction for Idahoans to calculate a modified Schedule A.

Ms. Warren said there are some significant and unprecedented federal retroactive provisions for businesses involving changes to the treatment of foreign income of affiliates and income received from foreign subsidiaries. The changes are retroactive to 2017, are in place at the signing of the Act, and require tax payers to report and pay taxes on previously unreported overseas earnings or profits from domestically owned foreign corporations. Prompt action by the Idaho Legislature would provide much needed guidance to Idaho taxpayers. These provisions have some unknown affects on multinational corporations that file Idaho income tax returns, and it is really difficult to estimate changes that will occur. The tax reform legislation creates some new IRC sections as well. The retroactive changes will generate a positive fiscal impact, but there is no historical data from which to make projections.

Tom Shaner, Tax Policy Manager, Commission, was introduced to respond to house and senate committee questions. Concerning the Commission's conformity impact analysis of a positive unknown for the 2017 retroactive business provisions, Mr. Shaner explained the apportionment process utilized by the Commission to calculate the revenue impact of conformity and the lack of a basis to identify a specific amount that would be creditable. He stated that revenue projections going forward would be problematic because multinational companies report this revenue with dividends making it difficult to delineate sure revenue with accuracy. Mr. Shaner was unaware of any other states making a dollar estimate and such an estimate would not apply to Idaho. Mr. Shaner clarified that repatriation represents a shift from a worldwide taxing system at the federal level to a more common territorial system. Failure to conform would put Idaho at a disadvantage with multistate and national companies. He said Idaho business will begin changing their federal withholding affecting paychecks, and Idaho withholding will depend on Legislative action, which the Commission typically follows with withholding tables done by May. He advised that administrative changes and higher costs would result from a nonconformance by Idaho to one of the federal retroactive provisions, and adding an Idaho child tax credit would require statutory action.

Cynthia Adrian Tax Policy Specialist, Commission, spoke about 2018 individual tax conformity. The federal standard deduction increased, and Idaho conformity would reduce Idaho revenue by $340.5 million. The Act eliminated the personal exemption and dependent exemptions, and conformity to eliminating Idaho's personal exemption would increase Idaho revenue by $272.3 million, and eliminating Idaho's dependent exemptions would increase Idaho revenue by $139.5 million. Most federal itemized deductions were eliminated or capped, and Idaho conformity would result in an increase in Idaho revenue of $55.3 million. The definitions were changed for qualified expenses from a federal 529 Education Savings account, and if Idaho conforms, it would reduce Idaho revenue by approximately $6 million. Idaho conformity to all these federal changes would be an increase of $118.8 million. IRS announced it will temporarily implement and work with changes to the existing W-4 forms to be published in January and implemented in February. The Commission will communicate and provide guidance to Idaho employers and employees based upon current legislative action.

Mr. Shaner, addressed the business effects of the Act stating the expense limits increased from $500,000 to $1 million via an accelerated depreciation method in effect since 1958, to which Idaho conforms, and the phase-out increased from $1 million to $2.5 million. The change is different from the bonus depreciation introduced as a temporary measure in 2001, reintroduce in 2007, and to which Idaho does not conform. Idaho's conformity to these changes will reduce Idaho revenue by $6 million. Federal simplified accounting increases the threshold for a small business to use accrual basis accounting from $5 million in gross receipts to $25 million. Idaho conformity will reduce Idaho revenue by $12.8 million. The federal interest expense deduction is limited to 30% of the sum of adjusted taxable income and taxable interest income. The excess will be carried forward in the NOL, to which Idaho does not conform, and it will need to be addressed if the Legislature chooses to allow businesses to carry the excess over. Conformity would increase Idaho revenue by $14.2 million.

Tax deferred 1031 exchanges are limited to real estate. Idaho conformity increases Idaho revenue by $800,000. There is a change in the S corporation to C corporation conversion, and Idaho conformity brings a negative $800,000 impact. Federal inclusion of income rules have changed, and Idaho conformity increases Idaho revenue by $2 million. The domestic production deduction originally meant to encourage investment in domestic facilities provision is not needed anymore because a lot of the foreign repatriation changes accomplish the same thing. Idaho conformity increases Idaho revenue by $7.3 million.

The employee entertainment expense and recreational membership deductions are no longer allowed, and Idaho conformity increases Idaho revenue by $2.7 million. Employee commuting and parking expenses are no longer allowed, and Idaho conformity increases Idaho revenue by $2 million, although the business travel deduction is still allowed. The Act reduces pass-through income by 20% on the owner's income tax return, but because Idaho's top tax rate for individuals and the tax rate for corporations are the same, the federal justification doesn't exist for Idaho. Because of the way the federal legislation is written, Idaho's conformity would pick up this provision, and the Legislature needs to take specific action in a separate bill to not conform to this provision. The net of Idaho conformity to all the business expenses is a reduction of $21.4 million.

Mr. Shaner informed the committees, in response to their questions, that the Commission strived to be as accurate as possible in their estimates, but spending projections are economic and cannot be taken into account. The Commission does a one-year-at-a-time fiscal impact and conformity analysis. The impact of Idaho conformity from accelerated depreciation and cash versus accrual accounting would have a $6 to 12 million impact the first year but not in subsequent years, so it would not be an ongoing loss. Also, a federal inclusion of income rules increase in 2018 will not occur again in 2019 and would not be ongoing.

Mr. Shaner further replied to committee member questions saying no federal information is available on the implications of federal tax liability for Idaho individuals and businesses, but the corporate tax rates have dropped dramatically, and most taxpayers will have a lower taxable liability. Regarding personal income tax, the Commission looked at which Idahoans and how many will be effected by the state and local tax limit in the new $10,000 federal law, and they are having property tax research done because the real impact is going to be on people who have over $10,000 property tax on a residence, which could include a second home. The Commission expects the pool of people who itemize to shrink from about 145,000 to 135,000.

Regarding committee member questions concerning changes to the federal standard dependent deduction, **Mr. Shaner** said Idaho conformity is at a neutral baseline and anything else is a policy decision. Mr. Shaner also responded that lowering the corporate tax rate in Idaho is a policy choice and a disparity between wage earners and business owners would still exist.

Chairman Roberts advised that later this week the Economic Revenue Assessment Committee will meet to address the fiscal effects of increased economic activity on revenue projections.

ADJOURN: There being no further business to come before the committee, the meeting adjourned at 9:39 a.m.

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Representative Collins
Chair

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Susan Steed
Secretary